

DEEP TECH FUND 2020/12 MARKET CONSULTATION

**On Call to select a private fund manager
for establishing and managing a deep
tech investment fund**

**SMART>
CAP**

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➤ MARKET CONSULTATION

AS SmartCap, a fund management company established under the laws of Estonia with registry code 12071991 (hereinafter **SmartCap**), is intending to launch a Call for Expression of Interest (hereinafter the **Call**) in order to select a private fund manager (hereinafter the **Fund Manager**) for establishing and managing a deep tech investment fund (hereinafter the **Fund**), to which **Early Fund II**, a venture capital fund-of-funds managed by SmartCap would make a cornerstone investment in an amount of € 15 million. The principal purpose of the Fund will be to increase the availability of venture capital in Estonia for research and development intensive early-stage technology companies.

SmartCap invites interested parties to review and submit comments on the draft Main Terms of the Fund and draft requirements of the Business Plan to be submitted by applicants together with the final Expressions of Interest (hereinafter **EoI**) at the Call. Drafts of each document are provided below. The final version of the Main Terms and Business Plan requirements published at the Call may differ in part or in whole to this draft version published for market consultation.

All comments should be sent no later than 23 November 2020 in English via e-mail to info@smartcap.ee with a subject line “*Deep Tech Fund 2020/12 - Market Consultation*”

SmartCap will hold a **market consultation presentation on 11 November 2020** for potential applicants interested in participating in the Call. Please contact SmartCap directly at the e-mail address provided above, if you are a potential applicant and interested to register for the event. Registered participants will receive details of the event by e-mail.

➤ MAIN TERMS OF THE FUND

Subject	Term
Fund structure	<p>The Fund shall be established as a limited partnership (<i>usaldusfond</i>) under the laws of Estonia or similar form in the European Union acceptable for SmartCap and according to best industry practices.</p> <p>The Fund Manager and all related entities (e.g. investment advisor, carried interest vehicle) shall be established in the European Union.</p> <p>The Fund Manager and all related entities shall be directly and indirectly controlled by the Key Executives and the directors, officers and employees of the Fund Manager.</p>
Early Fund II Contribution	<p>15,000,000 euros</p> <p>SmartCap may, at its sole discretion, decrease or propose to the successful applicant to increase the commitment of Early Fund II, however the total commitment of Early Fund II shall in no case exceed 70% of the total Fund size.</p>
Private Investor Contribution	<p>The expected aggregate amount of finance to be attracted from private investors at the level of the Fund shall be indicated by applicants in the EoI.</p>
Fund size	<p>Applicants are invited to propose the minimum, target and maximum Fund size in the EoI.</p>
State aid	<p>No state aid, pari-passu investment (i.e. at least 30% Private Investor Contribution which is invested at the same time and under the same terms as Early Fund II Contribution) and Distribution Cascade.</p>
Financial Commitment of the Team	<p>At least 2% of the Fund size. Applicants should include proposals in the EoI in relation to the level of the Financial Commitment of the Team (which must include all Key Executives) to the Fund. The Financial Commitment of the Team shall be included in the calculation of the Private Investor Contribution.</p>
Initial Closing	<p>Initial Closing of the Fund should take place when the proposed minimum Fund size is achieved. Initial Closing of the Fund is expected to take place within 6 months from signing the Early Fund II Contribution.</p>
Final Closing	<p>Final Closing of the Fund is expected to take place in 12 months from Initial Closing. An extension of up to 6 months may be permitted with the prior investor approval.</p>
Fund Term	<p>Up to 12 years from the Initial Closing + possible extensions subject to prior investor approval. Applicants are invited to propose the specific duration of the Fund together with any extensions in the EoI.</p>

Investment Period	Up to 4 years from the Initial Closing + possible extension subject to prior investor approval. Applicants are invited to propose the specific duration of the Investment Period together with any extensions in the EoI.
Follow-on investments	Follow-on investments into portfolio companies are permitted during and following the Investment Period subject to certain caps and limitations to be set out in the investment documents. Applicants are invited to propose the specific follow-on investment strategy in the EoI.
Investments	<p>The Fund shall make direct investments into privately held non-listed deep tech companies, which meet all of the following criteria:</p> <ul style="list-style-type: none"> (i) Early-Stage (as defined below) high-tech SMEs; (ii) the product or service is mainly based on scientific advancement and development or meaningful engineering innovation; (iii) the product or service development results in commercializable intellectual property.
Stage focus	<p>The Fund shall have a predominant focus on Early-Stage investments. For these purposes Early-Stage shall mean the following development stages:</p> <ul style="list-style-type: none"> – (Pre-) seed stage means the stage of development of an enterprise that needs funding to complete research, product definition or product design, including market tests and creating prototypes before a business has reached the start-up stage. This stage includes low scale pilot production, demonstration and/or development of associated business application of tested and validated products/technologies. – Start-up stage means the stage of development of an enterprise which has a fully developed product or service and which needs further funding to start mass production / distribution and initial marketing. The enterprise may be in the process of being set up or may have been in business for a short time, but has not sold its product commercially. – Other early stage means the phase of development of an enterprise that has completed the product development phase and recently initiated commercial manufacturing and/or sales and needs further funding before the break-even point. The enterprise will not yet be generating a profit. <p>For the avoidance of doubt, this includes seed and financing rounds up to but not later than series A financing. Early-Stage status shall be assessed at the time of initial investment in a portfolio company.</p> <p>Applicants are not required to focus on all development stages within the definition of Early-Stage and are invited to propose their investment focus in the EoI.</p>
Geographical focus	The Fund shall only invest into enterprises that have an establishment or branch in Estonia, except up to 100% of the Private Investor Contribution raised at Fund level can be invested outside Estonia provided that such investments do not exceed 50% of the total amount invested by the Fund in portfolio companies.
Investment form	Equity or quasi-equity

Borrowing and guarantees	The Fund may not borrow money, issue guarantees or otherwise incur indebtedness.
Re-investment	Applicants are invited to include specific proposals (if any) in relation to permitted re-investment in the EoI. Any re-investment will be subject to caps and limits to be set out in the investment documents. In any event, the Fund may not draw down more than 100% of total commitments to fund the acquisition cost of investments in portfolio companies and related transaction costs.
Management Fee	Applicants are invited to propose in the EoI a Management Fee based on market practice (i.e. amount and structure of the Management Fee including any step-down post-Investment Period). Any separate fee income generated by the Fund Manager or its affiliates related to the Fund's activities must be paid to the Fund or 100% offset against the Management Fee.
Distribution Cascade (together with hurdle rate / catch-up percentage / carried interest)	<p>Applicants are invited to propose in the EoI a Distribution Cascade based on market practice including the minimum hurdle rate, catch-up percentage (if any) in relation to the hurdle rate and carried interest percentage. The Distribution Cascade shall be pari passu for all investors of the Fund.</p> <p>It is expected that carried interest escrow or security arrangements may be required in the investment documents to secure any carried interest clawback obligations with respect to the Fund Manager.</p>
Fund Manager	The Fund Manager shall be an entity legally entitled to manage the Fund pursuant to applicable laws. The Fund Manager shall have a dedicated investment team composed of experienced professionals with an appropriate skill set and knowledge of the Estonian market and significant presence in Estonia. The Fund Manager shall operate in accordance with best industry practices including professional standards issued by Invest Europe and other recognised industry bodies. The Fund Manager shall operate independently.
Exclusivity	<p>During the Investment Period, none of the Fund Manager, Key Executives or affiliates may close, advise, manage or market any other fund, collective investment vehicle or managed account, or perform any functions or duties of a similar nature they undertake on behalf of the Fund, for any other person without prior SmartCap approval.</p> <p>Until the end of the Investment Period, all investment opportunities reasonably falling within the Fund strategy received by the Fund Manager, any of the Key Executives or any of their affiliates, will first be allocated to the Fund. During the Investment Period, none of the Fund Manager, Key Executives nor their affiliates shall invest in investment opportunities reasonably falling within the Fund strategy, other than through the Fund.</p>
Key Executives	During the Investment Period the Fund Manager must retain at least two Key Executives who must devote substantially all of their business time and attention to the business and affairs of the Fund. Following the Investment Period, the Key Executives shall devote such time and attention to the business and affairs of the Fund as is necessary and appropriate for the proper management of the affairs of the Fund. At least half of the full-time Key Executives must be residents of Estonia.

	<p>Applicants are invited to propose the composition and time devotion of other team members, including additional Key Executives (if any) in the EoI. The Key Executives may be replaced only with the prior consent of SmartCap and according to the procedures foreseen in the investment documents.</p>
Investment Committee	<p>The Fund Manager shall form an Investment Committee which shall be independent from the influence of investors or other third parties and should wholly or primarily be comprised of the Key Executives.</p>
Advisory Committee	<p>The Fund shall have an Advisory Committee, comprised of representatives of the most significant investors in the Fund (excluding investors representing the Financial Commitment of the Team, the Key Executives, Fund Manager and their affiliates). The Advisory Committee of the Fund shall convene at frequencies to be established in the investment documents and shall have functions that include: (i) providing overall guidance to the Fund Manager, (ii) reviewing the activities and governance of the Fund, (iii) reviewing any conflicts of interest and approving proposals on how to resolve such conflicts of interest, and (iv) such other duties as are specified in the investment documents. SmartCap or its representatives will be entitled to at least one seat on the Advisory Committee.</p>
Conflicts of interest	<p>The Fund shall enter into all transactions on an arm's length basis.</p> <p>The Fund Manager shall immediately refer and fully disclose to the Advisory Committee any activities which could create an opportunity for actual or potential conflicts of interest to arise and shall seek the determination of the Advisory Committee as to the course of action to be taken.</p>
Investment Restrictions	<p>The Fund will invest through subscriptions for new shares in portfolio companies and will seek to acquire existing shares only if necessary to strengthen the Fund's existing position in a portfolio company or where non-core management or earlier stage investors are exiting at the same time as the Fund's subscription for new shares.</p> <p>The Fund shall not engage in or make investments which engage in speculative investment activities such as real estate investments when undertaken as a financial investment activity, invest in any financial derivative instrument, including the purchase or sale of options, currency or other futures, crypto currencies, tokens, forward currency contracts, or commodities or commodity futures or options.</p> <p>The Fund shall not make bridging investments with the view to subsequently syndicating such investment to other third parties.</p> <p>The Fund will not engage in commercial bank-type, senior or non-equity related lending.</p> <p>The Fund will not be involved in hostile bids or investments made where the board of such company has expressed its objection to such investment.</p> <p>The Fund will not operate as a fund of funds and there shall be no investments in other investment funds or collective investment vehicles.</p>

	<p>Any changes to the Investment Restrictions will require the prior consent of SmartCap.</p> <p>Applicants are invited to stipulate appropriate diversification limits for the Fund in the EoI.</p>
Removal of the Fund Manager	<p>The investors may at any time remove and replace the Fund Manager or terminate the Fund without cause by written notice approved by a super-majority of investors unaffiliated to the Fund Manager.</p> <p>Upon the occurrence of a cause event, the investors may remove the Fund Manager or terminate the Fund by written notice approved by a majority of investors unaffiliated to the Fund Manager. The circumstances defining “cause” will be set out in detail in the investment documents.</p>
Responsible investing	<p>The applicants propose a framework for a management system to systematically address environmental, social and governance (ESG) issues in the investment activities of the Fund in the EoI.</p>
Reporting	<p>The Fund Manager shall provide quarterly and annual reporting in a standardised form and scope, in compliance with the reporting guidelines published or endorsed by Invest Europe, and provide all additional information which may be required by SmartCap (including impact metrics and ESG reporting) or applicable regulations or law in effect from time to time or which shall otherwise be stipulated in the investment documents. The Fund Manager shall also provide annual audited financial statements in accordance with applicable laws. The valuation of investments in portfolio companies shall be made in accordance with the valuation principles published or endorsed by Invest Europe from time to time, being currently the International Private Equity Valuation Guidelines.</p>

› REQUIREMENTS OF THE BUSINESS PLAN

› Applicant's (proposed) team, shareholders and structure:

- List of Key Executives and other members of the team (including any expected positions to be recruited at relevant fund sizes), detailing who would be full-time dedicated and who would be part-time dedicated (including, if applicable, Investment Committee members, venture partners, industry advisers, entrepreneurs in residence, etc.) to the Fund (with % of full-time equivalent time dedication);
- Division of roles and responsibilities and the (planned) locations of the team members;
- If having existing business activities, a list of joiners and leavers of the team in the last 3 years, their date of arrival/departure, position at arrival and current title;
- Details of team members' other activities and/or work assignments (including any management, supervisory, advisory board or other similar seats) not related to the Fund and estimated time (together with % of full-time equivalent time dedication) required to perform other tasks during the Fund Term;
- Details of the previous joint experiences and co-operation of the team members;
- Organizational chart showing management structure and actual (if existing) or anticipated (if planned to establish a new entity) ownership of all relevant Fund entities, including Fund Manager, general partner (if different from the Fund Manager), investment advisor (if any) and carried interest vehicle (if any);
- Detailed shareholder base and ultimate beneficial ownership of the Applicant (to the extent different to the above);
- Three references (including e-mail addresses and telephone numbers) for each investment team member (if possible, related to transactions relevant to the proposed strategy: e.g. CEOs of investees, co-investors, other).

› Applicant's market experience and knowledge:

- In case of an Applicant that is an established legal entity – detailed history of the Applicant and its and affiliates' previous and existing business activities, including details of any existing related funds under management;
- Competence(s) of each team member that will be contributed to the Fund Manager, including early stage investment experience and competence of the team members, and investments and/or expertise in deep tech;
- Description of the competitive advantage of the proposed management team;

- Track record of the Fund Manager team members in Excel format, including realised and unrealised investments:
 - name of investee;
 - location;
 - sector;
 - investment development stage;
 - date of entry and exit;
 - invested amount;
 - instrument;
 - ownership %;
 - proceeds received to date;
 - exit multiple of cost (realised);
 - exit type;
 - current fair value;
 - multiple of cost (unrealised);
 - gross IRR;
 - role of team member in transaction;
 - indication of whether each company is deep tech;
 - name and contact details of at least one founder for each company;
 - where the track record involves formal funds, in addition to individual transaction information, gross and net fund level returns should be included.
 - Description of previous collaboration with other (co)investors, market players, etc.;
 - Description of relevant networks and relationships built with the public and private sector, including universities, research centres, laboratories, incubators, etc.
- › Fund's strategy and investment approach
- Minimum/target/maximum fund size to execute the strategy, including the rationale for the assessment;
 - Description of the market opportunity, including the targeted market segment(s) and rationale for why the targeted segment(s) represent an attractive investment opportunity;
 - Detailed overview of the Fund focus, including: (i) financial instruments to be used, (ii) target investment stakes, (iii) development stage, (iv) sector (v) geographical focus (including target markets and % outside Estonia, if any) and (vi) exit strategy;
 - Outline of the Fund portfolio model at relevant targeted Fund sizes (broken down by development stage where applicable), including: (i) target number of investments, (ii) ticket sizes, (iii) expected holding period of investments, (iv) capital deployment rate (including capital reserves, reinvestment and follow-on investment strategies, if any), together with illustrative financial model of the Fund in Excel format in each case for every proposed fund size scenario;
 - Targeted returns (including at the portfolio company level and net to investors) and how they will be generated;

- Terms and conditions proposed to be applied in relation to possible investments, including expected protective rights and economic terms (e.g. conversion caps, liquidity preferences, anti-dilution mechanisms);
- How the investment strategy is linked to deep tech and Estonia and how it contributes to the development of the Estonian economy;
- Risks/barriers related to implementing the investment strategy and their potential impact on the Fund together with proposed mitigants and risk management measures;
- Description of competitive landscape and Fund's competitive position;
- Envisaged co-operation with main market participants in the relevant market segments (including, if relevant, universities, science hubs, business incubators and entrepreneurship initiatives);
- Proposed duration of the Investment Period and the Fund Term and the rationale for choosing each (if less than the maximum permitted in the Main Terms);
- Expected sources and strategy for generation of deal flow, including marketing strategy of the Fund;
- Indicative investment pipeline relevant to proposed investment strategy, including for each opportunity: name, sector, transaction type, indicative investment size, indicative stake, source of opportunity, proposed value creation plan, and potential exit route;
- Outline of the Fund Manager's expected investment approval process from origination to signing, including approval stages and overview of the Fund Manager's approach to the timing, content and process for investment due diligence;
- Overview of proposed post-investment management of portfolio companies and approach to monitoring, value-creation (including involvement in strategy, finance and/or operations of portfolio companies) and participation in portfolio company governance bodies;
- Fundraising status and plans, including envisaged commitments, expected timing, stage of discussion (if any), timeline for beginning Fund operations, and any conditionalities or special economic or governance rights attached to such potential commitments.

› Institutional capacity and alignment of interest

- Proposed legal structure (including proposed country of incorporation and legal form to be used) of the Fund and all relevant Fund entities, including the Fund Manager, general partner (if different from the Fund Manager), investment advisor (if any) and carried interest vehicle (if any), including the rationale for choosing the proposed structure;
- Description of the Fund Manager's proposed approach to risk management and compliance, including procedures and internal controls to prevent the Fund from being used to launder money, finance terrorist activities and whether there is (or will be) a team member assigned to the risk monitoring function;

- Services proposed to be outsourced from third parties regarding the Fund and the Fund Manager, and expected service providers, if already known;
- Details of any expected or confirmed advisors and industry experts to be engaged by the Fund Manager (including through any proposed industry/advisory board) and the respective cooperation structure, including how such individuals will contribute to the Fund, time and/or financial commitment (if any) and how they would be compensated by the Fund Manager;
- Proposed structure, membership and voting mechanics of the Investment Committee;
- Details of any actual or potential conflicts of interest with the planned Fund, including arising from any previous or existing activities not related to the Fund engaged in by any management team member, together with any measures proposed to deal with such actual or potential conflicts of interest;
- Description of environmental, social and governance (ESG) values and responsible investment strategy, including proposed framework for a management system to systematically address ESG issues in investment activities.

› Economic and financial terms of the Fund

- Proposed main economic terms for the Fund, including (i) the proposed Management Fees during and post Investment Period and (ii) the proposed Distribution Cascade including (a) the applicable hurdle rate and (b) any profit share (carried interest) as well as any catch-up mechanism for the Fund Manager (including a breakdown of carried interest allocation amongst the investment team), including in each case the relevant calculation methodology;
- Proposed Financial Commitment of the Team to the Fund, including (i) a description of the sources of finance and (ii) the proposed split between the team and, (iii) if the Fund Manager includes a financial, industrial or other sponsor, showing the split between sponsor and the investment team;
- Detailed operational budget for the Fund Manager, including details of the proposed remuneration of all investment professionals.

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